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Financial Markets

Irving Trust

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Economic Research &
Planning Division

Friday
(Noon)

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The downside break out in oil prices unsettled the financial markets this week and prompted speculation about how the Fed might react to this event. News that Nigeria lowered its oil price by $5.50 per barrel weakened the exchange value of the pound sterling and the dollar, and gold dropped sharply by $30 per oz. Concern over lower oil prices centers primarily on the impact of these lower prices on the debt-ridden LDCs whose revenues are dependent on the sale of oil. However, there are several other financial repercussions of lower oil prices, and most are positive. The drop in the price of gold undoubtedly reflects the belief of gold dealers that investors in traditional oil surplus states will have fewer financial resources to diversify into gold. The weakening of the dollar, which occurred later in the week, reflects speculation as to what the Federal Reserve might do in response to lower oil prices. What might we expect of the Fed?

Clues to the Fed's likely response are embedded in Chairman Volcker's recent remarks before the Senate Banking Committee. That testimony tilted toward fighting inflation; it discounted some of the progress made on the inflation front as being due to a combination of permanent and temporary factors. In that regard, lowering the contract price of oil would be a new, important, and enduring element in the outlook for inflation. A lower contract price for oil--even at unchanged spot oil prices--tends to reinforce market sentiment that lower oil prices will persist for some time. Through the salutary effects of this prospect on inflationary expectations, the Fed might gain room to let interest rates go lower.

Yet this result is not unambiguous. Lower oil prices by themselves will tend to stimulate the economy: A 12% drop in oil prices (about $4 per barrel) would stimulate real GNP in the U.S. by not quite 1/2%. Also, the economic recovery has already begun, and rapid growth in the money supply persists. Nevertheless, improved long-run prospects (plus continuing progress) on inflation coupled with ongoing international debt concerns still might tilt the Fed's decision toward lowering interest rates.

The job of stabilizing oil prices at a lower level is no easy task. Different needs exist among OPEC members and between OPEC and other oil producers. There is no prospect of oil prices falling to a level where they will be firmly underpinned by oil's marginal production cost. Oil price stability will depend on oil producers' recognition of their interdependence as well as on their mutual trust. Strong incentives will remain for the most financially strapped producers to undercut the market. As oil producers, taken as a group, have more to gain from an orderly price agreement than from having no agreement, a deal should be struck. This would be a positive factor in restoring global economic stability and confidence in the international financial system.

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Market Yields

	2/25/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	16.50%
Effective since	1/11/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.13	8.38	13.38
Repurchase Agreements	8.05	8.38	12.50
U.S. Treasury Issues			
Bills			
3 months	8.13	8.20	12.82
6 months	8.29	8.55	13.87
1 year	8.58	8.80	14.00
Coupons			
2 years	9.28	9.55	14.29
4 years	9.72	9.95	14.07
7 years	10.19	10.30	13.95
10 years	10.25	10.50	13.89
Long Bond	10.47	10.90	13.68
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.15	8.35	14.05
3 months	8.25	8.45	14.25
6 months	8.35	8.65	14.40
1 year	8.90	9.15	14.40
Banker's Acceptances			
1 month	8.27	8.53	13.95
3 months	8.49	8.70	14.87
6 months	8.71	8.98	15.35
Eurodollar Deposits			
1 month	8.88	8.88	14.50
2 months	8.94	9.00	14.81
3 months	8.94	9.13	14.94
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.12	8.38	13.35
1 month	8.17	8.42	13.84
3 months	8.28	8.54	14.04
Bank Holding Companies			
1 month	8.31	7.40	13.46
Dealer Placed:			
3 months	8.41	8.28	14.27
New AA Corporate Utility Bond	11.85	12.20	16.50
Tax Exempt			
6 month Project Notes	4.00	4.20	7.55
1 year AAA Bond	4.50	4.80	7.75
5 year AAA Bond	6.20	6.30	9.00
20 year AAA Bond	8.65	8.90	11.70

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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